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Economic growth, trade and investment*

Report of the Secretary-General

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I. Introduction

1. The deregulation of domestic markets in the last decade and their opening up to international competition have created expectations of faster growth and convergence of incomes at the global level, greater income equality at the national level, primarily in the developing countries, and increased economic stability.

2. Contrary to these expectations, there have been a number of negative developments such as unsatisfactory economic growth, greater instability of growth, income insecurity, and increasing income gaps within and across nations. There is an urgent need to redress low growth and the marginalization of a large number of developing, and especially least developed, countries.[1]

3. There has also been a growing realization that the world as a whole cannot follow the environment-intensive paths of production and consumption taken by the developed countries in the past. In order for economic growth to reach an environmentally sustainable trajectory, there is a need to decouple it from environmental stress and create environmental space for the developing countries. On the other hand, there are many environmental challenges which emerge not so much from growing affluence, but from growing poverty. Impoverishment and the absence of alternatives in low-growth economies lead to increased pressure by the poor and the landless on their natural resource base.

4. The fast pace of trade and investment liberalization has brought to the fore the cross-border dimensions of the growth-environment relationship. The present report focuses on how the integration of markets on a worldwide scale may influence economic growth, the international distribution of the gains from growth and the environmental implications of growth. It also describes ways in which the traditional objective of economic growth can be geared towards sustainable development through environment-related trade policies and environmental practices of transnational corporations.

5. The report also points out that there is a need for building confidence and consensus on a trade, environment and development agenda that would balance the interests of both the developed and the developing countries. Such an agenda should be based on the objectives set out in the Rio Declaration on Environment and Development,[2] Agenda 21,[3] and the Marrakesh Agreement Establishing the World Trade Organization (WTO). It should seek to enhance the contribution of the multilateral trading system to sustainable development and to find solutions outside the WTO framework.

6. On the foreign direct investment (FDI) front, private and public interests in protecting the environment have yet to converge. Governments seek to promote sustainable development within a national context; transnational corporations strive to enhance their competitiveness in an international context. The latter are finding that competitiveness and environmental protection need not be mutually exclusive and hence are becoming increasingly concerned with the public perception of their environmental impacts. The former are testing new and innovative approaches to tap the large, and mostly unexplored, potential of transnational corporations to contribute to sustainable development.

II. Economic growth

7. In recent years, developing countries have become more and more dependent on external resources for the achievement of growth rates sufficient to tackle the problems of poverty and underdevelopment. In almost half of the developing countries examined in the *Trade and Development Report 1999*,[4] including exporters not only of commodities but also of manufactures, the trend is one of falling or stagnant growth rates. Among the countries that succeeded in achieving faster growth, the majority experienced deteriorating trade balances, financed by inflows of private capital. However, such inflows could not always be sustained and eventually led to currency crises, economic contraction and import cuts.[5] A drastic decline in commodity prices and weather disasters have exacerbated the trend of falling or stagnant economic growth rates so that for the first time since 1988 the growth in developed countries exceeded that in the developing countries.

A. Economic growth and the environment

8. From a long-term perspective, world economic growth could be constrained by the limited absorptive capacity of the environment, at both national and

international levels. Until now, environmental policy has not been a noticeable constraint on national economic growth. The situation could change, however, if environmental constraints become more noticeable.

9. The world as a whole cannot follow the resource- and environment-straining patterns of production and consumption taken by developed countries. In order to reach globally sustainable development, there is a need to progressively uncouple economic growth from environmental stress and create environmental space for developing countries. Most of the scenarios for rapid growth with minimum environmental degradation in the global context converge on the need for delinking economic growth from natural resource use and associated pollution in absolute terms (i.e. less consumption of natural resources in developed countries) and in relative terms (i.e. less consumption of natural resources per unit of gross domestic product (GDP)) in developing countries.

10. There are a number of scenarios dealing with environmental space. The Factor Four scenario[6] holds the promise of doubling economic output while reducing resource use by half and describes concrete techniques to achieve this. Apart from cuts in energy consumption, there are possibilities for reducing the use of wood, water and minerals while increasing living standards. The Factor Ten scenario requires that the developed countries cut down on the use of resources and emissions more than tenfold in the coming decades, thus creating additional environmental space for the developing countries.

11. The United Nations Conference on the Environment and Development (UNCED), which linked environmental policy with development, emphasized that for effective environmental policies it is necessary first and foremost to address poverty and inequality issues. The proposed scenarios call for developed countries to take the lead in changing production and consumption patterns to provide environmental space for the developing countries, as well as promoting technology transfer and financial assistance. They also require that interactions between the developed and developing countries in trade, science, technology and finance take the form of partnerships, based on the principles of the right to development and the rights of future generations.

12. In developed countries the relation between growth and environmental degradation has taken many forms. While in most cases water pollution and sulphur dioxide emissions have been reduced at high levels of development, consumption of fossil fuel and emissions of carbon dioxide have not. While the consumption of some metals per unit of GDP, such as tin and zinc, has fallen considerably, several other metals, such as steel and copper, have only been replaced by other metals, plastics or wood. However, such inter-material substitution has not, or has only marginally, reduced total material intensity of growth. Likewise, while in Japan the energy intensity of economic growth has declined slightly, it has continued to grow in the United States of America.

13. The material/resource intensity of growth, which is also indicative of the pollution intensity of economic growth, is influenced by several factors. In developed countries, the following factors have contributed to decoupling:

(a) Intersectoral changes in the economy (i.e. restructuring), leading to a higher share of less resource-intensive sectors, such as services, in total GDP;

(b) Higher eco-efficiency, which leads to the reduction of material consumed;

(c) Changes in consumption patterns caused by enhanced environmental awareness.

14. Restructuring towards the service sector has been in full swing in most developed countries for a good number of years and can be expected to slow down in the future. Conversely, changes in consumption patterns induced by increased environmental awareness could accelerate. With the exception of a few areas (such as food, beauty and health-care products and agricultural commodities), however, the effect of such changes is marginal and will take time to increase in relative importance. It can therefore be concluded that the development, diffusion and effective use of modern, eco-efficient technologies will be the most important factor in developed countries for reducing the material and pollution intensity of production.

15. New technologies open up new opportunities across almost the complete spectrum of human activity, particularly in information and communications and material science, leading to powerful knock-on effects for other areas such as energy use. Such developments

extend the limits of economic growth and have a significant potential of reducing its ecological footprint.

16. Despite the huge potential of technological progress, it is unlikely that the resulting material and resource savings will lead to an absolute decline in resource use in developed countries. Governments have a role to play in encouraging research and development through the use of incentives to new modes of production and consumption, such as drastically prolonging product life; leasing rather than buying products with a service contract; or reconditioning and reusing products. This requires changes in production and servicing costs to make such activities economically viable. Internalization of environmental externalities in prices of goods and services may therefore gain importance in government policies. Only policies such as these can guarantee that environmentally undesirable production and consumption methods are penalized by market forces and that material- and resource-saving methods are rewarded and become profitable.

17. In developing countries as well, restructuring,[7] eco-efficiency and changes in consumption patterns play a role in determining the environmental impact of economic growth. However, there are two other key factors that contribute to environmental stress: poverty and high population growth.

18. Most of these factors lead to increasing environmental impacts with economic growth in the South. Restructuring of economies in many developing countries follows, although in a less pronounced form, the classical path of industrialization based on material-intensive branches. The lack of modern, environmentally sound technology is preventing most developing countries from improving eco-efficiency of production and creating favourable conditions for technological leapfrogging. Significant changes in consumption patterns are unlikely to occur in the light of the catch-up demand for many consumer goods and the massive poverty in many developing countries. This is compounded by poverty-induced environmentally unsound production patterns. Rapid population growth is putting another significant strain on environmental resources. Therefore, appropriate policies are needed to break the undesirable trend towards increasing environmental stress in developing countries.

19. Because major environmental challenges also emerge from lack of growth, it is important first and foremost to meet people's basic minimum consumption needs. Secondly, scale effects of increased consumption accrue not only from the pattern of consumption but also from increases in population. Lastly, the technology needed to leapfrog into environmentally sound production and consumption patterns is not easily accessible to developing countries.

20. In an increasingly globalized world economy, poverty alleviation requires investment and trading opportunities in order to provide the employment and generate the income that will allow modifications of poverty-induced consumption patterns. Many small and medium-sized enterprises can play a significant role in this regard but have yet to benefit from trade liberalization. There is a need to enhance their supply capacity as well as their capacity to meet quality and environmental requirements in export markets.

21. In both developed and developing countries, technology is the make-or-break factor in reducing the environmental strain of economic growth, in general, and for providing environmental space for developing countries. Clearly, the current level of technology development and application is far below its potential for enhancing eco-efficient use of resources and for creating favourable conditions for technological leapfrogging in developing countries. To harness this potential, developing countries need access to technology and need to develop adequate human resources to acquire the ability to use clean technologies effectively. This will require open markets for products from developing countries and suitable international financial mechanisms to allow access to commercially available environmentally sound technologies. Foreign direct investment has a large potential for transferring such technologies and the required knowledge for their effective use. International property rights regimes should contribute to the indigenous development and transfer of much-needed environmentally sound technologies to developing countries.

B. Policy implications

22. The allocation of environmental space between nations is important for the achievement of sustainable development. Since globalization is driven by market

forces, it is important to ensure that the integration of markets does not result in the integration of market failures,[8] including those relating to public goods. Effective environmental policies are needed to prevent these failures or to manage them better when they occur.

23. A mere increase of eco-efficiency on the basis of technological solutions is not enough for absolute delinking of natural resource use from economic growth in developed countries. Absolute delinking also requires strong government policies and substantial changes in consumption patterns. Internalization of environmental costs and benefits in prices of goods and services will play a far more important role than in the past to make market forces work for freeing environmental space.

24. Ushering in global environmental sustainability will demand a much higher degree of organization and effective decision-making than at present. It will entail far higher levels of global cooperation in such areas as technology development, dissemination of technology and changes in consumption patterns. It will also entail a commitment of the international community to promote an increase of consumption levels of basic goods and services in developing countries.

III. Trade and the environment

A. In search of a balance

25. Globalization and trade liberalization can have both positive and negative effects on sustainable development. There is a continued need to support efforts by developing countries to integrate themselves into and derive benefits from the multilateral trading system. At the same time, full attention should be given to enhancing the contribution of the multilateral trading system to sustainable development, as well as to pursuing numerous opportunities outside the WTO framework.

26. The issue of balance in dealing with trade and the environment has become clear in the context of the Seattle Ministerial Conference. First, there should be a balanced approach to the various trade and environmental issues being considered in the context of the multilateral trading system. Second, trade and environment issues should be considered in the context of a broader sustainable development agenda.

27. There is a general consensus that trade and environmental policies can complement each other. However, it needs to be ensured that environmental measures do not act as unnecessary obstacles to trade or are protectionist in intent and that trade rules do not stand in the way of adequate environmental protection.

28. Concerns about the impacts of globalization on human well-being and environmental quality have to be taken seriously. Of equal concern is the viewpoint of developing countries that trade and environment linkages may mask protectionist intent. In the search for balance, Governments should promote enhanced understanding and broader consensus on the root causes of environmental degradation and the best ways of tackling them. This requires an examination of the implications for sustainable development of globalization and liberalization, as well as an examination of packages of policies that can be put in place to enhance the synergies between trade liberalization, environmental protection and other effects of sustainable development. Integrating trade and the environment in a manner supportive of economic development requires mechanisms that span several dimensions of national and international economic activity. These mechanisms can be developed through a combination of initiatives dealing with legislation and policy-making at the national and international levels, capacity-building, technical and financial assistance, public-private partnership, development of infrastructure and constructive engagement of civil society.

29. The basic parameters for such an agenda have already been set by the UNCED process, particularly the Rio Declaration, Agenda 21 and the Programme for the Further Implementation of Agenda 21 (General Assembly resolution S-19/2, annex), with their emphasis on international cooperation and on the principle of common but differentiated responsibilities in achieving sustainable development. It will be necessary to undertake an integrated examination of trade, finance, investment, technology and sustainable development, and to pursue a broad-based agenda in several forums, including WTO, the United Nations Conference on Trade and Development (UNCTAD), United Nations Environment Programme (UNEP) and the Commission on Sustainable Development.

B. Promoting sustainable development through trade

30. The Commission, in previous sessions, emphasized the important contribution that the removal of trade obstacles and distortions can make to sustainable development. Discussions have gradually moved from possible "win-win" or double dividend scenarios to "win-win-win" results, in terms of environmental, trade and developmental gains. In the preparations for Seattle, proposals have been made for the elimination of (a) subsidies that contribute to overcapacity in the fisheries sector; (b) agricultural export subsidies; (c) tariff escalation in the forest sector; and (d) restrictions on trade in environmental goods and services. More work is needed to extend these proposals to other products of export interest to developing countries, such as textiles and clothing, leather and leather products, footwear, forest products, minerals and mining products, other natural resource-based products and primary commodities.

31. The Commission, at its fifth session, recognized that trade liberalization should be accompanied by environmental and resource management policies in order to realize its full potential contribution to improved environmental protection and the promotion of sustainable development through the more efficient allocation and use of resources (see General Assembly resolution S-19/2, annex). At its second session, in 1994, the Commission noted the importance of developing a framework to facilitate the assessment of the environmental impact of trade policies, taking into account the special needs and conditions of developing countries (see E/CN.17/1994/20).

32. Emphasis has shifted from environmental impact assessments to sustainable impact assessments, which weigh costs and benefits in economic terms. This shift reflects an attempt to integrate economic, environmental and social development concerns. It is generally recognized that responsibilities for carrying out such assessments, as well as for making policy choices in the light of their results, lie with national authorities.[9] However, there could be a certain degree of international cooperation, for example with regard to methodological aspects or concerning capacity-building by multilateral institutions. A challenge is to anticipate potentially adverse scale effects of trade liberalization and, where possible, to avoid or mitigate such effects through appropriate environmental policies. Such assessments should also include the distribution of the gains from trade between developed and developing countries. Priority should be given to key sectors where changes in production patterns associated with trade liberalization and expansion is most likely to have an environmental impact. For example, UNEP, in cooperation with UNCTAD, has promoted a series of case studies on the environmental impacts of trade liberalization and policies for sustainable development of natural resources. The Organisation for Economic Cooperation and Development (OECD) recently held a workshop on methodologies for environmental assessment of trade liberalization agreements (26 and 27 October 1999). The World Wildlife Fund (WWF) is organizing an international expert group meeting on sustainability assessment of trade liberalization at Quito (6-8 March 2000), the results of which will be reported to the Commission on Sustainable Development at its eighth session.[10]

33. Environmental requirements may have positive and negative effects on trading opportunities. Developing countries have been concerned that certain environmental requirements may adversely affect access to the markets of developed countries. Developing countries may lack the technical and financial ability to comply with the environmental regulations of the industrialized nations. In the Seattle preparatory process, some developing countries expressed concern about the trade effects of environmental standards and the manner in which international standards are being developed. They argued, *inter alia*, for full implementation of technical assistance provisions in the Technical Barriers to Trade Agreement and for full participation of developing countries in the international standards-making process.

34. The work on market access carried out by UNCTAD shows that large firms generally do not encounter difficulties in meeting environmental requirements, but small and medium-sized enterprises often do. One important lesson learned is that in most cases, competitiveness concerns can be addressed by the adoption of appropriate policies and measures at the national and international levels. A number of developed countries have acquired experience in cooperating with their major developing country trading partners, for example through consultations prior to the introduction of new standards, the

organization of workshops aimed at disseminating information and technological cooperation. However, as proposed in Agenda 21 and post-UNCED deliberations, there is a need to further develop certain concepts and propositions that could be considered when designing and implementing environmental policies with potentially significant trade effects. In addition, the General Assembly, at its nineteenth special session, called for particular attention to be paid to the needs of small and medium-sized enterprises.

35. The Commission has repeatedly emphasized that consumer preferences for environmentally preferable products offer new trading opportunities for developing countries. Several developing countries have indeed expanded exports of such products (as well as "fair trade" products). The challenge now is to increase the number of developing countries and their enterprises that can turn this potential into practical financial, social and environmental gains. Heightened consumer concerns in the area of food safety and quality has generated renewed demand for organic food. Experience has been acquired in overcoming policy, market and technical obstacles, such as lack of information, technical capacity and policies at home and abroad. The business community also has an important role to play, in particular since the purchasing policies of large retailers as well as the supply chain management of large companies may have a large impact on the demand for environmentally preferable products.

36. An important issue is how to make certification more affordable for small producers, through such mechanisms as "umbrella certification" of certain products (i.e., certification of entire geographical areas or groups of producers rather than individual enterprises) or the development of regional and national certification bodies. Another issue that has been raised in earlier deliberations in the Commission is how trade incentives (including through improved market access) could be provided for the production of environmentally preferable products, in particular inherently environmentally preferable products originating in developing countries. The promotion of environmentally preferable products may involve other trade and environment issues; for example, the promotion of production of and trade in environmentally preferable products based on traditional knowledge and production methods may involve such issues as biodiversity and the protection of intellectual property rights.

37. The use of criteria based on production and process methods in the context of international trade raises a range of very diverse issues. Incentives and enabling measures will assist developing countries in moving towards more environmentally friendly production and process methods. Intergovernmental institutions and NGOs have paid increased attention to multi-stakeholder approaches as a means to move towards the use of more environmentally friendly production and process methods. The efforts of many developing countries to promote the use of environmental management systems, for example in accordance with ISO 14001, is commendable in this regard.

C. Making trade and environment mutually supportive

38. The important role of multilateral environmental agreements in addressing global environmental problems on the basis of international consensus has been fully recognized. Much of the debate in the Committee on Trade and Environment has focused on the relationship between trade measures pursuant to such agreements and the provisions of the multilateral trading system. Agenda 21 and the Commission have welcomed a clarification of this relationship. Trade measures can, in certain cases, play a role in achieving the objectives of a multilateral environmental agreement. At the same time, the international community has widely recognized the important role of supportive measures (such as capacity-building and improved access to finance and technology) to assist developing countries in meeting multilaterally agreed targets in multilateral environmental agreements. The Commission, at its fourth session, recognized that different trade provisions in multilateral environmental agreements may have different objectives and that they may involve broader economic and developmental issues. These issues have been further analysed in a 1999 OECD report on trade measures in multilateral environmental agreements.

39. Although there is wide agreement that there should be a harmonious relationship between multilateral environmental agreements and the multilateral trading system, there is no agreement on the question of whether any modification of WTO rules

is needed. Some have proposed to accommodate trade measures pursuant to multilateral environmental agreements, for example through an interpretation of the General Agreement on Tariffs and Trade (GATT), article XX (Exceptions). Others argue that article XX of GATT already provides sufficient room for trade measures which are implemented in an appropriate way. No trade measures pursuant to multilateral environmental agreements have been challenged in the WTO to date. Important issues nevertheless remain unresolved.

40. The international debate has spawned several measures that may help to avoid conflicts between trade measures in multilateral environmental agreements and the WTO rules, including (a) strengthened coordination at the national level; (b) strengthened cooperation between the WTO, UNEP and the multilateral environmental agreement secretariats (for example, the secretariats of several multilateral environmental agreements have provided briefings in Committee on Trade and Environment and WTO symposia. UNEP has organized workshops bringing together the secretariats of UNEP-administered conventions, WTO and UNCTAD); (c) the creation of working groups on trade issues in multilateral environmental agreement negotiations or the further development of such instruments (as was put in practice during the final negotiations of the Rotterdam Convention on Prior Informed Consent measures); and (d) establishment of joint business/NGO expert groups (such a proposal was made at a WTO symposium in July 1998); and (e) better implementation of positive measures. A suggestion to provide guidelines to dispute settlement panels dealing with environmental issues has also been mooted in this regard.

41. The ability of developing countries to respond to environmental challenges depends to a large extent on their access to environmentally sound technologies. Agenda 21 has emphasized the importance of promoting access to and transfer of such technologies, on fair and favourable terms. One of the objectives of the WTO Agreement on Trade Related Intellectual Property Rights (TRIPS), laid down in its article 7, is the promotion of technological innovation and transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare, and with a balance of rights and obligations. Some developing countries have proposed that implementation of the TRIPS Agreement should pay more attention to the objectives of its article 7. This would also be applicable to technologies which are mandated by multilateral environmental agreements.

42. Technologies are largely transferred through enterprises, and not through government-to-government operations. Nevertheless, there are some commitments on the part of Governments of developed countries. For example, developed countries are committed to provide sufficient resources for the financial mechanisms attached to transfer of technology provisions in multilateral environmental agreements. In addition, both the TRIPS Agreement and certain multilateral environmental agreements contain provisions obliging governments to provide incentives to enterprises and institutions for the transfer of technologies.[11] An across-the-board examination on how to strengthen transfer of technology provisions in the WTO agreements would be useful. In the context of preparations for Seattle, some developing countries proposed to establish a working group on technology in WTO.

43. Developing countries are the largest repositories of biodiversity and traditional knowledge and seek to derive larger benefits from products which are based on their biodiversity. Key concerns of developing countries are (a) the relationship between rights and obligations under the Convention on Biological Diversity, on the one hand, and the TRIPS Agreement on the other; and (b) the wider ethical, economic, environmental and social issues of patenting life forms. Developing countries have made a series of proposals aimed at ensuring compatibility between the principles of the Convention and the TRIPS Agreement, in particular with regard to protecting the rights of communities, farmers and indigenous people, as well as sovereignty and prior and informed consent, with a view to promoting equitable benefit-sharing. Concerning the wider ethical, economic, environmental and social issues of patenting life forms, several developing countries would like to widen the options for excluding life forms from patentability. Some are of the view that plants, animals and essentially biological processes must never be patented. There should be closer cooperation between WTO, the World Intellectual Property Organization (WIPO), the Convention on Biological Diversity, UNEP,

UNCTAD,[12] the Food and Agriculture Organization of the United Nations (FAO) and other relevant institutions on this issue. Progress should be made in identifying appropriate forms for the protection of traditional, local and indigenous knowledge. More work is needed to examine the options for the implementation of effective *sui generis* systems. In addition, NGOs could play an important role in building confidence between Governments from developed and developing countries.

44. At its fifth session, the Commission recommended that within the framework of Agenda 21, trade rules and environmental principles should interact harmoniously (see General Assembly resolution S-19/2, annex). In preparation for the Seattle Ministerial Conference, some countries proposed that the Ministerial Declaration should contain a reference to certain environmental principles contained in the Rio Declaration, such as the precautionary principle and the polluter pays principle. Developing countries have highlighted the importance of other UNCED principles, in particular principle 7 on common but differentiated responsibilities.

45. References to the precautionary principle are in several multilateral environmental agreements, such as the Montreal Protocol on Substances that Deplete the Ozone Layer, the United Nations Framework Convention on Climate Change and the Convention on Biological Diversity. Therefore, many observers consider that the precautionary principle has become part of the body of international environmental law. The precautionary principle has also found reflection in article 5.7 of the WTO Agreement on Sanitary and Phytosanitary Measures. It allows members, under certain conditions, to provisionally adopt sanitary and phytosanitary measures in cases where relevant scientific evidence is insufficient. However, it allows only for temporary measures, subject to further research and reviews. One important question is whether the current trade rules provide sufficient room to deal with both food safety concerns on the one hand and the potentially adverse trade effects of sanitary and phytosanitary measures on the other. These questions have been raised in the beef/hormones dispute, and are also relevant in the context of public concern about genetically modified organisms.

46. Some have noted that it could be worth examining to what extent the precautionary principle could be used, where appropriate, to require proof by the exporter of a minimum level of safety for trade in potentially risky products (such as domestically prohibited goods, hazardous wastes and chemicals), in particular where developing countries lack capacity to control and test imports. Many WTO members, however, are concerned that greater flexibility in the use of the precautionary principle might have adverse trade effects, as its abuse or poor application could foreclose market access. Improved coordination between WTO work and that of other international organizations, such as FAO and the World Health Organization (WHO), may help to build confidence in the ability to promote trade in food products while responding to legitimate concerns in the area of food safety and ethics in food trade.

47. There has been much concern, particularly in the developed countries, about perceived lack of transparency and insufficient environmental inputs to the WTO dispute settlement mechanisms. Yet, it has been observed that the WTO dispute settlement panels and its appellate body have become more conscious of the environmental dimension of their arguments. Others have expressed concerns about the implications of the development of case law. Legal decisions arrived at under dispute settlement mechanisms will not necessarily take account of the same considerations currently discussed in the balanced agenda of the Committee on Trade and Environment and may not reflect the wishes of all member States. Trade and environment issues can be resolved on a case by case basis through the use of panels and the appellate body. Alternatively, members themselves can examine whether there is a need to modify trade rules, based on a consensus process. This should help to reduce pressure on dispute settlement mechanisms.

48. Progress has been made in increasing transparency of dispute settlement, for example by lifting restrictions on documents and posting them on the WTO web site immediately after their distribution to WTO members. Progress has also been made in assisting developing countries in the area of dispute settlement through the creation of an advisory centre on WTO law at Geneva.

D. Institutional issues

49. Both developed and developing countries have attached great importance to the work of the Committee on Trade and Environment. The Committee

has made a considerable contribution to enhancing understanding of trade and environment issues, and its work has also encouraged research and policy coordination at the national level. In the Seattle process, there has been some debate on the role of the Committee in helping to ensure that future trade negotiations contribute to sustainable development. Many countries have stated that the Committee should continue to work with its current mandate and balanced agenda.

50. The United Nations, through such institutions as UNCTAD, UNEP, the United Nations Industrial Development Organization (UNIDO), the United Nations Development Programme (UNDP), and the International Trade Centre (UNCTAD/WTO), have an important role to play in promoting the integration of trade and environment. UNCTAD's major objective is to examine trade and environment issues from a development perspective. Its work focuses on policy analysis, consensus-building and capacity-building. The General Assembly, at its nineteenth special session, requested UNCTAD to continue to play a key role in the implementation of Agenda 21, through the integrated examination of linkages among trade, investment, technology, finance and sustainable development (see General Assembly resolution S-19/2, annex). UNCTAD's future work plan will be decided by UNCTAD at its tenth session.

51. The Economics and Trade Unit of UNEP is carrying out a range of activities which examine and develop policy responses to the interactions of economics, finance and trade with the environment. This work aims to enhance the capacities of countries, particularly developing countries and those with economies in transition, to integrate environmental considerations in development planning and macroeconomic policies, including trade policies. Among the activities in the work programme are country studies on environmental assessment of trade liberalization, policy-oriented research on the impact of fisheries and energy subsidies on the environment, and production of a handbook on environment and trade to explain the complex interlinkages to a wider audience. Much of this work will complement that being done by UNCTAD, and the two organizations are envisaging a joint capacity-building task force on environment, trade and development.

52. Civil society has an increasingly important role to play in promoting a balanced agenda on trade and sustainable development. In several areas, NGOs are at the forefront of research and the promotion of policy dialogues. Civil society produces regular newsletters and devotes considerable resources to public outreach. NGOs are also involved in capacity-building. In many developing countries, NGOs work closely with the Government, for example in the area of sustainable agricultural development and the protection and sustainable use of biodiversity. Several environmental and developmental NGOs have also established useful cooperation with the business community, for example in the promotion of trade in environment-friendly products and the wider use of environmental management systems.

53. The Commission on Sustainable Development, at its third, fourth and fifth sessions, emphasized the need for capacity-building in the area of trade, environment and development. Its eighth session provides an opportunity to review capacity-building needs as well as to take stock of existing and planned capacity-building programmes. This may help to identify gaps, promote coordination and cooperation, and increase the usefulness and efficiency of capacity-building efforts. The Commission may also wish to consider how capacity-building can help to promote a process of confidence-building. A background paper on capacity-building in trade and sustainable development will be issued to aid the Commission in its deliberations.

E. Risks and opportunities

54. Intergovernmental deliberations on trade, environment and development could aim at consolidating progress and building confidence. There has been growing recognition that trade and environment interactions need to be addressed within the broader context of development. Developed countries must implement their commitments in terms of finance, access to and transfer of technology and capacity-building. It needs to be ensured that environmental standards do not act as obstacles to trade. Confidence-building is needed to create better chances of arriving at balanced arrangements, supported by both developed and developing countries, aimed at ensuring that future trade negotiations contribute to the achievement of sustainable development. Confidence-building is also needed to keep the momentum in ongoing efforts to promote

policy dialogues and coordination at the national level, in particular in developing countries.

55. The Commission may wish to propose elements of a broad agenda aimed at exploring and promoting synergies between trade liberalization, environmental protection and other elements of sustainable development, in accordance with the objectives set out in the Marrakesh Agreement Establishing WTO, the Rio Declaration and Agenda 21. Such an agenda should be based on an integrated examination of linkages between trade, investment, technology, finance and sustainable development. It should consider both the contribution that the multilateral trading system can make to achieving sustainable development as well as solutions outside the multilateral trading system.

56. Developing and implementing a constructive agenda to consolidate progress and build confidence and consensus requires coordinated efforts in several forums, including WTO, UNCTAD, UNEP, other institutions and civil society. The Commission may wish to consider how the capacity-building programmes of different multilateral institutions, such as UNCTAD, UNEP, UNDP and WTO, as well as civil society, can help to strengthen dialogue and build confidence between developed and developing countries. The joint UNEP/UNCTAD initiative aimed at establishing a task force to pool the expertise and networks of the two institutions could be a useful point of reference.

IV. Making foreign direct investment work for sustainable development[13]

A. A new business context

57. There has been a tenfold increase of FDI in the last 10 years, including in pollution-intensive sectors. However, besides volume effects, the environmental impact of FDI depends critically on two factors: environmental management systems and the transfer of environmentally sound technology.

58. The level of environmental degradation resulting from industrial activity is closely linked to the production efficiency of firms and their capacity to innovate. Environmental damage tends to be greatest in low-productivity operations working with obsolete technology, outdated work methods, poor human resource development, inefficient energy use and limited capital.

59. This suggests that there is much scope for firms to improve their environmental performance by adopting corporate strategies that promote the development and mastery of technological processes and that facilitate the adoption of environmental management systems that include process control, continuous improvement and organizational learning. What this means is that to a large extent, environmental performance is a function of the use of clean technology within an efficient environmental management framework.

60. There are diverging views on the impact of transnational corporations on sustainable development in developing countries. On one hand, they are seen as a repository of clean technologies that facilitate sustainable development; on the other hand, they are accused of relocating polluting production and inferior technologies to their subsidiaries, exploiting technology gaps, not taking responsibility for their "environmental footprint" and undermining efforts to achieve sustainable development.

61. The demand for change from transnational corporations with regard to the environmental impact of their operations on the environment is reflected in the increased stringency of national environmental regulations in a growing number of countries. This concern has also found its way into international commitments. Most prominent among them is Agenda 21, which contains a number of provisions across five chapters that are directly addressed to transnational corporations. Environmental issues have been embedded in some international investment agreements. The Bolivia-United States bilateral investment treaty, for example, makes reference to the environment. At the regional level, concern over the environmental effects of liberalized trade and investment led to the establishment of the North American Commission for Environmental Cooperation in the framework of the North American Free Trade Agreement.

62. Cross-border environmental management is not just about traditional concerns over pollution. It is also about scale. A lot of environmental problems, actual and potential, have to do with the sheer size of the operations of transnational corporations rather than merely the way they conduct their business. Low

pollution-content activities with large outputs and poor environmental control can do significant environmental damage, such as in the areas of agribusiness and logging.

63. For the developing countries, the issue of environmental protection is also about time or rather lack of it. The pressure of delivering high growth rates and attracting FDI means that policy decisions have to be taken in response to immediate output and employment objectives. The lack of resources and expertise in monitoring and enforcement, and sometimes the inability to work collaboratively with transnational corporations, add to the problem.

64. Regulatory and ethical considerations are and will always be important in steering FDI towards environmental sustainability. But they are no longer the main determinants of the FDI-environment relationship. The focus of attention — and action — has shifted to the economics of environmental management. Corporate strategies of compliance are giving way to eco-performance considerations, the life cycle approach to products and production processes and the internalization of environmental costs. Managing environmental risks is becoming a standard feature of corporate behaviour as transnational corporations are finding considerable competitive advantages in being "green". Such commitments, however, are far from universal. Increasing competition and tough-minded management styles often make maximizing profit the overwhelming objective. When these are combined with monopoly power on the global stage, consumer and environmental interests may get sacrificed. External pressures may be needed, such as public disclosure laws for monitoring and accountability of the transnational corporations. In using this information, civil society may often be more effective by emphasizing incentives for good performance, such as awards and publicity, over more conventional regulatory approaches.

B. Environmental management systems and practices

65. A movement towards greater transparency and the reorganization of the value-added chain on an international scale has been shaping cross-border environmental management. Transnational corporations now employ a wide range of environmental systems and practices, from comprehensive approaches that ensure that their worldwide environmental impacts are addressed consistently (centralized strategy) to those that focus on ensuring compliance with local regulations (decentralized strategy). The environmental implications for host countries depend on the type of strategy followed by a transnational corporation and the public policy network within which a particular strategy is pursued.

66. Environmentally efficient management practices tend to be used in the corporate system as a whole when heavy investments with a long life cycle are involved, firms are highly visible, high liabilities are possible and environmental requirements of third-party lenders come into play. This arises, not necessarily because firms are particularly environmentally conscious (although this may well be the case for a number), but because it makes good business sense in this context. Such a strategy can work particularly well in highly integrated industries, such as natural resources and capital-intensive industries. In labour-intensive industries, an important variable is the degree to which the value-added chain is integrated: the more it is integrated, the greater the incentive for environmental upgrading. In fact, where upgrading becomes the de facto norm of an industry, firms risk being singled out, including by their competitors, if they fail to rise to the new standards.

67. Not all firms do — or can — pursue this centralized strategy. Most firms, especially small and medium-sized transnational corporations, adopt a decentralized strategy. Some may seek to establish uniform standards but may fail because of a lack of skills or resources; others operate in parts of the market that are not equally affected by environmental concerns. This also applies to less prominent firms in the developed countries and to a large number of small and medium-sized transnational corporations and suppliers to foreign transnational corporations which compete primarily on price. These firms have neither the resources nor the clear payback guaranteed from making long-term investments in technology and efficient environmental managerial practices.

68. What is becoming increasingly relevant is the environmental management responsibilities of transnational corporations vis-à-vis their suppliers (and consumers). Transnational corporations should cooperate with their arm's length suppliers in developing countries with a view to assisting them to improve their environmental performance. In this case,

it is not ownership that matters but rather that they are related to a transnational corporation system.

C. Transfer of environmentally sound technology

69. Transfer of environmentally sound technology is not just about plant, equipment or consultancy services. It involves the sharing of the knowledge, expertise and experience required to manage technical change, and the development of human resources to implement organizational changes and improve overall production efficiency and environmental management throughout the plant and facility.

70. Globalization of production processes, regulatory, peer, supply chain and internal pressures, codes of conduct, action groups, financial considerations, environmental change — the relative weight of those factors in environmentally sound technology transfers differ from company to company and from sector to sector. The success factors in the transfer of environmentally sound technologies include a shift from "end-of-pipe" approaches to process modification, the development of innovative technologies to respond to the particular needs of developing countries, and technology diffusion allowing domestic suppliers and firms to benefit from technology flows.

71. Public procurement plays an important role in improving technology transfer. By setting environmental requirements, public authorities could use their purchasing power to promote technology transfer. Moreover, they could assist in making it accessible to the local industry through licensing.

72. Strategic alliances and joint ventures create the best conditions for the transfer of environmentally sound technologies, while backward and forward linkages between transnational corporations and local companies serve as a conduit for the spillover effects. In this context, it is particularly important to address the situation of small firms and explore ways to transfer environmentally sound technology to them.

D. Multi-stakeholder approach to cross-border environmental management

73. Foreign ownership can matter in that corporate systems can become conduits for the transfer of environmental management practices and environmentally sound technologies, reaching even beyond the corporate system per se where comprehensive uniform corporate standards are in place. In general, however, it is an unresolved issue whether domestic versus foreign ownership of facilities makes a significant difference when it comes to environmental performance. Other factors — such as size, vintage of plants, skill levels, technology and host country regulation — may well be as or more important. Moreover, the picture may differ from industry to industry and is further complicated by the fact that some industries (especially in natural resources and capital-intensive production) are dominated by transnational corporations.

74. In the absence of systematic evidence, it is impossible to arrive at a general conclusion about the importance of ownership when it comes to environmental impact. However, the ability of transnational corporations to adapt to the changing regulatory framework for environmental issues could be an important asset that they can bring to host developing countries. Host country policy measures can be designed in a manner that encourages transnational corporations to deploy this asset and to make full use of the potential they have to contribute to environmentally sound development. The challenge for policy makers — especially in the presence of intense competition for FDI and the chilling effect this could have on environmental regulations — is to accentuate the positive environmental contributions that transnational corporations can make while reducing the negative ones. Against this objective, Governments must balance their goals in terms of increased investment, output, exports, technology transfer and job creation, which can differ considerably across countries and levels of development. As is often the case, choosing the right trade-offs is difficult.

75. A crucial policy intervention point for Governments is at the time of entry of a transnational corporation, especially when it comes to large-scale projects and particularly in pollution-intensive industries. Competition for FDI should not result in using low environmental standards as a tool with which

to attract FDI, if only because empirical evidence shows that a number of other factors are more important for FDI locational decisions. In addition, in the new business context, there is now an incentive for companies not to take advantage of such regulatory inducements.

76. Host country Governments once relied heavily on screening as a mechanism to review the contribution of FDI to their economies. This mechanism, however, is no longer as effective as it once was. Nevertheless, a useful tool for improving the environmental performance of firms, regardless of nationality, is to require environmental screening prior to the implementation of projects. This, however, demands special skills. In any event, Governments can require, especially in the case of big projects, that transnational corporations provide their corporate environmental policy statements and report regularly on their environmental performance.

V. Conclusions and recommendations

77. Economic growth should (a) support development with a view to reducing welfare gaps between developed and developing countries and (b) be environmentally and socially sustainable. Both economic growth and the lack of it can cause environmental degradation. Among the root causes of environmental degradation are unsustainable production and consumption patterns and poverty-related pressures on the environment in developing countries.

78. Technology plays a key role in "delinking" growth and environment impacts. Developing countries are important arenas for innovation and leapfrogging in both process and product technologies. Technologies that should be encouraged in developing countries comprise, *inter alia*:

(a) Low-cost technologies for providing basic needs, such as housing, water, sanitation and health care;

(b) Clean production processes and efficient technologies for waste management;

(c) Efficient "next generation" technologies;

(d) Low cost, simple but efficient technologies developed for poor people;

(e) Agricultural technologies for ecologically fragile areas;

(f) Technological innovation in environmental public goods, such as energy-saving public transportation;

(g) Building social and information infrastructure in developing countries to promote innovation and absorption of technologies.

79. Effective environmental policies should focus on correcting market failures, removing perverse subsidies, establishing and enforcing adequate environmental regulations, promoting the use of economic instruments, strengthening national institutions and promoting international cooperation.

80. The eighth session of the Commission could contribute to confidence-building and improved dialogue between countries with a view to moving forward the discussions on trade, environment and development. Implementing a constructive agenda to consolidate progress and build confidence and consensus requires coordinated efforts in several forums, including the WTO, UNCTAD, UNEP, other institutions and civil society. This may be rendered more effective by:

(a) Strengthening cooperation between the secretariats of WTO, UNCTAD and UNEP in pursuing a balanced, transparent and broad-based agenda on trade, environment and development;

(b) Building capacity in developing countries to deal with trade-related environmental and environment-related trade issues;

(c) Implementing effectively Agenda 21;

(d) Promoting integrated, multi-stakeholder approaches to identify cost-effective and development-friendly options for trade and environment policy integration.

81. Enhancing the synergies between trade liberalization and sustainable development requires that full attention is paid, including in the work of WTO, UNCTAD, UNEP and other institutions, to, *inter alia*:

(a) Safeguarding and improving market access for products from developing countries;

(b) Promoting new trading opportunities for developing countries, including for environment-friendly products;

(c) Continuing work on the sustainability impacts of trade liberalization in a manner which is sensitive to the distribution of gains from trade between nations;

(d) Removing trade obstacles and distortions;

(e) Exploring "win-win-win" scenarios.

82. There should be a harmonious relationship between multilateral environmental agreements and the multilateral trading system. This, *inter alia*, requires coordination at the national level, as well as cooperation between the secretariats of the WTO, UNEP and the multilateral environmental agreements. The Commission may wish to reiterate its invitations to UNEP and UNCTAD, issued at its third and fourth sessions, to examine the trade and developmental implications of multilateral environmental agreements.

83. Further work is needed on the trade implications of the full range of environmental principles, including the precautionary principle and the polluter pays principle. Further work is also needed on the application of the principle of common but differentiated responsibility, which provides a basis for an equity approach to achieving global environmental objectives.

84. The ability of developing countries to respond to environmental challenges depends to a large extent on their access to environmentally sound technologies. There is a need to promote the indigenous development and transfer of environmentally sound technologies to developing countries, including through the implementation of articles 7 and 66.2 of the TRIPS Agreement.

85. Progress should be made in identifying appropriate forms for the protection of traditional knowledge, including options for mutual benefit-sharing schemes. There should be close cooperation between WTO, WIPO, the Convention on Biological Diversity, FAO, UNEP and other relevant institutions, including NGOs.

86. Foreign direct investment and transnational corporations have a large but mostly unexplored potential to contribute to sustainable development in host developing countries. Enhancing this potential, *inter alia*, requires:

(a) Exploring ways to ensure that a larger number of countries benefit from FDI;

(b) Promoting the use of environmental management systems in and transfer of environmentally sound technologies to subsidiaries in developing countries, as well as their diffusion to other companies in the host developing country;

(c) Exploring possibilities for encouraging investors to apply best practices;

(d) Exploring the potential for improving environmental performance along the supply chain and in waste management, in cooperation with other stakeholders;

(e) Building multi-stakeholder approaches to promote environmentally sound FDI;

(f) Enhancing transparency, e.g., by encouraging effective public disclosure procedures to promote best practices and environmentally responsible corporate behaviour.

Notes

[1] A number of developing countries have been growing faster than industrialized countries, but not fast enough to narrow the absolute per capita income gap. Only a handful of East Asian economies have managed to sustain growth rapid enough to narrow the gap with the North, or in some cases even to catch up. However, as these economies have graduated into the high-income club, few developing countries have been able to step into their place. Significantly, the trend towards a widening of gaps between income groups is apparent in both more and less successful developing countries and is associated with export-oriented as much as with inward-oriented strategies.

[2] *Report of the United Nations Conference on Trade and Development, Rio de Janeiro, 3-14 June 1992*, vol. I, *Resolutions Adopted by the Conference* (United Nations publication, Sales No. E.93.I.8 and corrigendum), resolution 1, annex I.

[3] Ibid., annex II.

[4] United Nations publication, Sales No. E.99.II.D.1.

[5] Only few countries, notably China and Chile, have been able to buck this general trend by combining faster growth with improved trade performance.

[6] Ernst von Weizsäcker, Amory B. Lovins and L. Hunter Lovins, *Factor Four: Doubling Wealth, Halving Resource Use: The New Report To The Club Of Rome* (London, Earthscan Publishing, 1997).

[7] In developing countries with a weak industrial base, a rapid and sustained rise in the levels of income depends on increasing investment, which has a very high import content. This in turn requires an initial reliance on natural endowments for the export earnings needed to finance imports and investment. However, the exploitation of these endowments can be detrimental to sustainable development when the resources, such as minerals, are not renewable, or their rate of depletion is greater than the rate of restoration, as in the case of timber. The pressure on natural endowment will vary between countries, but it is likely to be greater when imports are liberalized before a sound and competitive industrial export base is established.

[8] Hans Opschoor, "Mondialisering en Institutioneel Verankerd Internatuionaal Milieubeleid", in *Essays Internationalisering van het Miliebeleid*, 1999.

[9] In some cases, there may be cooperation in the context of regional integration agreements, such as the European Community and the North American Free Trade Agreement.

[10] This meeting, hosted by the Government of Ecuador, is organized in collaboration with Fundación Futuro Latino Americano and with the financial support of several OECD Governments.

[11] TRIPS Agreement, articles 66.2 and 67, and the Convention on Biological Diversity.

[12] UNCTAD's BIOTRADE initiative provides technical cooperation to help developing countries strengthen their capacities to enhance the sustainable management of biological resources.

[13] This section draws on the outcome of a pre-UNCTAD X seminar on the theme "Making FDI work for sustainable development", Geneva, November 1999, and on chapter X of the *1999 World Investment Report*.